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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER Chairman  
WILLIAM A. MUNDELL  
MARC SPITZER  
MIKE GLEASON  
KRISTIN K. MAYES

W-01303A-05-0280  
WS-01303A-02-0867  
WS-01303A-02-0869  
WS-01303A-02-0870

IN THE MATTER OF THE APPLICATION OF  
ARIZONA-AMERICAN WATER COMPANY, INC.,  
AN ARIZONA CORPORATION, FOR AUTHORITY  
TO IMPLEMENT ARSENIC COST RECOVERY  
MECHANISMS FOR ITS AGUA FRIA WATER,  
AND TUBAC WATER DISTRICTS.

**STAFF'S NOTICE OF FILING  
DIRECT TESTIMONY**

The Utilities Division ("Staff") of the Arizona Corporation Commission hereby files the  
Direct Testimony of Staff witness Crystal S. Brown in the above-referenced matter.

**RESPECTFULLY SUBMITTED** this 1<sup>st</sup> day of July, 2005.

Timothy J. Sabo  
Attorney, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007  
(602) 542-3402

The original and thirteen (13) copies  
of the foregoing were filed this  
1<sup>st</sup> day of July 2005 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Copies of the foregoing were mailed this  
11<sup>th</sup> day of March 2004 to:

Administrative Law Judge, Teena Wolfe  
Hearing Division  
Arizona Corporation Commission  
1200 West. Washington Street  
Phoenix, AZ 85007

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S/

Arizona Corporation Commission

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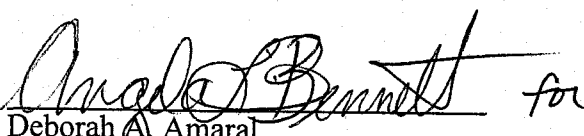
1 Craig A. Marks, Esq.  
2 Corporate Counsel, Arizona-American Water Co.  
3 19820 North 7<sup>th</sup> Street, Suite 201  
4 Phoenix, AZ 85024  
5 Attorney for Arizona-American Water Co.

6 Thomas M. Broderick  
7 Manager, Government and Regulatory Affairs  
8 Arizona-American Water Co.  
9 19820 North 7<sup>th</sup> Street, Suite 201  
10 Phoenix, AZ 85024

11 David P. Stephenson  
12 Director of Rates and Revenues  
13 American Water Works Service Co., Inc.  
14 303 H. Street, Suite 250  
15 Chula Vista, CA 91910

16 Walter W. Meek  
17 AUIA  
18 2100 North Central Avenue, Suite 210  
19 Phoenix, AZ 85004

20 Daniel Pozefsky  
21 Residential Utility Consumer Office  
22 1110 West Washington Street, Suite 220  
23 Phoenix, AZ 85007

24  for  
25 Deborah A. Amaral  
26 Secretary to Timothy J. Sabo  
27  
28

W-01303A-05-0280  
WS-01303A-02-0867  
WS-01303A-02-0869  
WS-01303A-02-0870

**DIRECT  
TESTIMONY  
OF  
CRYSTAL S. BROWN**

**DOCKET NO. W-01303A-05-0280**

**IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER  
COMPANY, INC., AN ARIZONA CORPORATION, FOR AUTHORITY TO  
IMPLEMENT ARSENIC COST RECOVERY MECHANISMS FOR ITS AGUA FRIA  
WATER, SUN CITY WATER, HAVASU WATER, AND TUBAC WATER DISTRICTS**

**JULY 1, 2005**

**BEFORE THE ARIZONA CORPORATION COMMISSION**

JEFF HATCH-MILLER  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
MARC SPITZER  
Commissioner  
MIKE GLEASON  
Commissioner  
KRISTIN K. MAYES  
Commissioner

IN THE MATTER OF THE APPLICATION OF )  
ARIZONA-AMERICAN WATER COMPANY, )  
INC., AN ARIZONA CORPORATION, FOR )  
AUTHORITY TO IMPLEMENT ARSENIC COST )  
RECOVERY MECHANISMS FOR ITS AGUA )  
FRIA WATER, SUN CITY WATER, )  
HAVASU WATER, AND TUBAC WATER )  
DISTRICTS )  
\_\_\_\_\_ )

DOCKET NO. W-01303A-05-0280

DIRECT  
TESTIMONY  
OF  
CRYSTAL S. BROWN  
PUBLIC UTILITIES ANALYST V  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

JULY 1, 2005

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### **Exhibit**

Chaparral City Water Co., Average Capital Structure of Sample Water Utilities – Sch AXR-2

### **Attachment**

Memorandum from Marlin Scott, Jr., Utilities Engineer

**EXECUTIVE SUMMARY**  
**ARIZONA-AMERICAN WATER COMPANY**  
**DOCKET NO. W-01303A-05-0280**

Arizona-American Water Company, Inc. ("Arizona-American") provides potable water, irrigation water, and wastewater services to approximately 115,000 customers in Arizona.

On April 15, 2005, Arizona-American filed an application for authority to implement Arsenic Cost Recovery Mechanisms ("ACRM") for its Agua Fria, Sun City West, Havasu, and Tubac water districts. On May 4, 2005, Arizona-American filed a motion to delete Tubac Water District from its application.

On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for the Havasu water district.

Staff recommends the following:

1. Authorization of the requested ACRM.
2. Arizona-American file a plan with the Commission's Docket Control by December 31, 2005, that describes how the Company will attain and maintain a capital structure (equity, long-term debt and short-term debt) with equity representing between 40 percent and 60 percent of total capital. Staff will address the plan in the Company's Paradise Valley Water Company rate proceeding (Docket No. W-01303A-05-0405).
3. The Company should file by April 1st each year subsequent to any year that it has ACRM collections a report with the Utilities Division Director showing its ending capital structure (equity, long-term debt, and short-term debt) by month for the prior year.
4. The rate base calculation (Schedule 7) for the Havasu water district be modified to explicitly show a deduction for Arsenic Impact Fee collections.
5. The Earnings Test schedule filed in support of the ACRM should incorporate adjustments conforming with Decision No. 67093. For example, the acquisition adjustment should be removed from rate base and the amortization of the adjustment should be removed from the income statement. The actual period results, adjustments, and adjusted period should be clearly shown on each Earnings Test Schedule. The earnings test places a cap on the ACRM surcharge based on the existing authorized rate of return.
6. Microsoft Excel or compatible electronic versions of the filings and all work papers be concurrently provided to Staff with all ACRM filings.
7. The Company should file the schedules discussed in its application except as modified in the above recommendations. In addition, Staff reserves the right for further discovery as it deems necessary related to the ACRM filings.
8. The Company should file an application for a permanent rate increase for its Agua Fria, Sun City West and Havasu water districts no later than April 30, 2008, using 2007 as the test year.
9. Approval of Havasu's Arsenic Impact Fee ("AIF") Tariff as modified by Staff and reflected in Staff's attached Tariff Schedule – Arsenic Impact Hook-up Fee.
10. Havasu be required to file a calendar year status report each January 31<sup>st</sup> with Docket Control for the prior twelve (12) month period, beginning January 31, 2006, until the AIF Tariff is no longer in effect. This status report should contain a list of all customers that

have paid the AIF Tariff, the amount each has paid, the amount of money spent from the account, the amount of interest earned on the AIF Tariff account, and a list of all facilities that have been installed with the AIF Tariff funds during the 12 month period.

**INTRODUCTION**

**Q. Please state your name, occupation, and business address.**

A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

**Q. Briefly describe your responsibilities as a Senior Rate Analyst.**

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. In addition, I develop revenue requirements, prepare written reports, testimonies, and schedules that include Staff recommendations to the Commission. I am also responsible for testifying at formal hearings on these matters.

**Q. Please describe your educational background and professional experience.**

A. I received a Bachelor of Science Degree in Business Administration from the University of Arizona and a Bachelor of Science Degree in Accounting from Arizona State University.

Since joining the Commission, I have participated in numerous rate cases and other regulatory proceedings involving large electric, gas, telecommunications, and water utilities. I have testified on matters involving regulatory accounting and auditing. During the past nine years, I have attended utility-related seminars on regulation, accounting, finance and income taxes designed to provide continuing and updated education in these areas. Various professional and industry organizations sponsored these seminars.



1 I have been employed by the Commission as a regulatory auditor and a rate analyst since  
2 August 1996. Prior to joining the Commission, I was employed by the Department of  
3 Revenue as a Senior Internal Auditor and by the Office of the Auditor General as a  
4 Financial Auditor. I was a Cost Center Review Specialist for Blue Cross Blue Shield of  
5 Arizona prior to my employment in state government.

6  
7 **Q. What is the purpose of your testimony?**

8 A. I am presenting Staff's recommendations concerning Arizona-American Water  
9 Company's ("Arizona-American" or "Company") requests for (1) arsenic recovery  
10 mechanisms ("ACRM") for its Havasu, Sun City West, and Agua Fria water districts, and  
11 (2) for an Arsenic Impact Fee for its Havasu water district. Staff witness, Marlin Scott,  
12 Jr., is also presenting Staff's engineering analysis and recommendations regarding the  
13 Company's Arsenic Impact Fee request for its Havasu water district in an attached  
14 memorandum.

15  
16 **BACKGROUND**

17 **Q. Please review the background of this application.**

18 A. Arizona-American Water Company, Inc. provides potable water, irrigation water, and  
19 wastewater services to approximately 115,000 customers in Arizona.

20  
21 On November 22 and December 13, 2002, Arizona-American Water Company, Inc. filed  
22 applications for fair value determinations of its utility plant and for permanent rate  
23 increases for five of its districts. On June 30, 2005, the Commission issued Decision No.  
24 67093 that established fair values and authorized permanent rate increases for the five  
25 districts.

26

1 On December 17, 2004, Arizona-American filed a motion to request that the Commission  
2 re-open the record in Decision No. 67093. The purpose of the motion was to provide an  
3 evidentiary basis that would allow the Commission to consider modifying the order so that  
4 an Arsenic Cost Recovery Mechanism could be added. Decision No. 67593, dated  
5 February 15, 2005, authorized the re-opening of the rate case order "solely for adding an  
6 Arsenic Recovery Mechanism."

7  
8 On March 29, 2005, Arizona-American was directed by procedural order to file a new  
9 application requesting an ACRM. The new application was to include all dockets from  
10 Decision No. 67093 that would be affected by the ACRM request. On April 15, 2005,  
11 Arizona-American filed an application for authority to implement ACRM's for its Agua  
12 Fria, Sun City West, Havasu Water, and Tubac Water Districts. Additionally, the  
13 Company requested a hook-up fee for its Havasu and Tubac Water Districts. On May 4,  
14 2005, Arizona-American filed a motion to delete Tubac Water District from its  
15 application.

16  
17 On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for  
18 the Havasu water district. On June 8, 2005, Arizona-American filed revised direct  
19 testimony for Company witness, Thomas M. Broderick.

20  
21 **CONSUMER SERVICE**

22 **Q. Please provide a brief history of customer complaints received by the Commission**  
23 **regarding Arizona-American's filing.**

24 **A.** Staff reviewed the Commission's records for the period April 1, 2005 to June 9, 2005 and  
25 found nine opinions have been made against the increase related to the arsenic removal.  
26

1 **SUMMARY OF RECOMMENDATIONS**

2 **Q. Please summarize Staff's recommendations.**

3 **A.** Staff recommends the following:

- 4 1. Authorization of the requested ACRM.
- 5 2. Arizona-American file a plan with the Commission's Docket Control by December  
6 31, 2005, that describes how the Company will attain and maintain a capital  
7 structure (equity, long-term debt and short-term debt) with equity representing  
8 between 40 percent and 60 percent of total capital. Staff will address the plan in  
9 the Company's Paradise Valley Water Company rate proceeding (Docket No. W-  
10 01303A-05-0405).
- 11 3. The Company should file by April 1st each year subsequent to any year that it has  
12 ACRM collections a report with the Utilities Division Director showing its ending  
13 capital structure (equity, long-term debt, and short-term debt) by month for the  
14 prior year.
- 15 4. The rate base calculation (Schedule 7) for the Havasu water district be modified to  
16 explicitly show a deduction for Arsenic Impact Fee collections.
- 17 5. The Earnings Test schedule filed in support of the ACRM should incorporate  
18 adjustments conforming with Decision No. 67093. For example, the acquisition  
19 adjustment should be removed from rate base and the amortization of the  
20 adjustment should be removed from the income statement. The actual period  
21 results, adjustments, and adjusted period should be clearly shown on each Earnings  
22 Test Schedule. The earnings test places a cap on the ACRM surcharge based on  
23 the existing rate of return.
- 24 6. Microsoft Excel or compatible electronic versions of the filings and all work  
25 papers be concurrently provided to Staff with all ACRM filings.

- 1           7.     The Company should file the schedules discussed in its application except as  
2                 modified in the above recommendations. In addition, Staff reserves the right for  
3                 further discovery as it deems necessary related to the ACRM filings.
- 4           8.     The Company should file an application for a permanent rate increase for its Agua  
5                 Fria, Sun City West, and Havasu water districts no later than April 30, 2008, using  
6                 2007 as the test year.
- 7           9.     Approval of Havasu's Arsenic Impact Fee ("AIF") Tariff as modified by Staff and  
8                 reflected in Staff's attached Tariff Schedule – Arsenic Impact Hook-up Fee.
- 9           10.    Havasu be required to file a calendar year status report each January 31<sup>st</sup> with  
10                Docket Control for the prior twelve (12) month period, beginning January 31,  
11                2006, until the AIF Tariff is no longer in effect. This status report should contain a  
12                list of all customers that have paid the AIF Tariff, the amount each has paid, the  
13                amount of money spent from the account, the amount of interest earned on the AIF  
14                Tariff account, and a list of all facilities that have been installed with the AIF  
15                Tariff funds during the 12 month period.

#### 17   **ASENIC COST RECOVERY MECHANISM**

- 18   **Q.     What is the new federal drinking water standard for arsenic and when will it go into**  
19         **effect?**
- 20   **A.     The United States Environmental Protection Agency's ("USEPA") new drinking water**  
21         **standard for arsenic is 10 parts per billion<sup>1</sup> effective January 23, 2006.**

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<sup>1</sup> The current USEPA drinking water standard is 50 ppb.

1 **Q. What are the estimated capital costs of complying with the new EPA arsenic**  
2 **standard?**

3 A. Arizona-American estimates that it will cost over \$42 million to construct new facilities to  
4 comply with the new USEPA arsenic standard. The costs for the Agua Fria, Havasu,  
5 Tubac, and Sun City West water districts will be approximately \$25 million.  
6 Additionally, significant operating expenses related to arsenic remediation are projected  
7 by the Company.

8  
9 **Q. What is the purpose of the Company's ACRM request?**

10 A. The purpose of the Arizona-American requested ACRM is to establish a methodology to  
11 calculate the additional costs related to arsenic treatment and disposal and to establish a  
12 mechanism for recovery from customers.

13  
14 **Q. Can Staff please describe Arizona-American's proposed ACRM?**

15 A. Yes. The Company states that the mechanism is essentially the same as that approved in  
16 the Arizona Water Company, Inc. Northern Division's ("Arizona Water") proceeding  
17 (Decision No. 66400, dated October 14, 2003).

18  
19 According to Company witness, Thomas M. Broderick<sup>2</sup>, the ACRM is as follows:

- 20 1. The ACRM is to be based on actual costs. The costs eligible for recovery are  
21 depreciation expense, gross return, and recoverable operations and maintenance  
22 expense ("O&M").  
23 2. Rate recovery for the ACRM begins after new facilities are in service and are in  
24 compliance with the new USEPA arsenic standard.

---

<sup>2</sup> Direct testimony of Thomas M. Broderick, at page 5, lines 1 through 19.

- 1           3. Deadlines for filing the next rate cases for the three water districts will be per  
2           existing Commission orders<sup>3</sup> with the exception that Arizona-American may file  
3           earlier if it chooses to do so. Arizona-American proposes to file an application for  
4           a permanent rate increase case for the Agua Fria and Sun City West water districts  
5           no later than April 30, 2008, using 2007 as the test year, and for Havasu no later  
6           than April 30, 2009, using 2008 as the test year.
- 7           4. The ACRM rate design will generate 50 percent of the costs from the monthly  
8           customer charge and 50 percent from the commodity.
- 9           5. Ten schedules as required in Decision No. 66400 will be filed with each ACRM  
10          request.
- 11          6. Recoverable operations and maintenance costs include only media replacement or  
12          regeneration, media replacement or regeneration service, and waste disposal.
- 13          7. A deferral for future recovery of up to 12 months of recoverable O&M without  
14          return commencing with the in-service of facility(s) within each district.
- 15          8. Two step-rate increases in each district with an ACRM.
- 16          9. No true-up of the ACRM for over or under collection.
- 17          10. Gross return included in the ACRM based upon earlier rate of return and return on  
18          equity findings which for Arizona-American was 9 percent authorized in Decision  
19          No. 67093, dated June 30, 2004.
- 20

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<sup>3</sup> Decision No. 66400, page 10 at line 9, "... file a general rate application ... no later than September 30, 2007, based on a 2006 test year." Staff interprets Arizona-American's statement as applying only to the Decision. The rate case moratorium imposed in Decision No. 65453 should remain unaffected.

1 **Q. Are the schedules and information that Arizona-American proposes to be filed for its**  
2 **ACRM the same as those required in Decision No. 66400 for the Arizona Water**  
3 **ACRM?**

4 **A.** Staff reviewed the schedules required per Decision No. 66400<sup>4</sup> and found that they are the  
5 same as those proposed by Arizona-American. The schedules and information that  
6 Arizona-American proposes to file are as follows:

- 7
- 8 1. Balance Sheet – The most recent balance sheet for the total Company at the time of
- 9 filing the ACRM request.
- 10 2. Income Statement – The most recent income statement for the total Company and
- 11 for the Agua Fria, Havasu, and Sun City West water districts.
- 12 3. Earnings Test – An earnings test calculation for the Agua Fria, Havasu, and Sun
- 13 City West water districts.
- 14 4. Rate Review Filing – A rate review calculation for the Agua Fria, Havasu, and Sun
- 15 City West water districts.
- 16 5. Arsenic Compliance Revenue Requirement – An arsenic compliance revenue
- 17 requirement calculation for the Agua Fria, Havasu, and Sun City West water
- 18 districts that is based upon arsenic plant and recoverable arsenic operating
- 19 expenses.
- 20 6. Surcharge Calculation – A detailed calculation of the surcharge.
- 21 7. Rate Base Schedule – A schedule showing the elements and the calculation of the
- 22 rate base.
- 23 8. CWIP Ledger – A ledger showing the transactions recorded in the construction
- 24 work in progress account.
- 25

---

<sup>4</sup> At page 14, beginning at line 9.

1     **Q. Did Staff compare Arizona-American's proposed arsenic mechanism to that**  
2     **authorized by the Commission for Arizona Water?**

3     A. Yes.

4  
5     **Q. What dates does Arizona-American's propose for filing permanent rate applications**  
6     **for the Agua Fria, Sun City and Havasu water districts?**

7     A. Arizona-American proposes to file permanent rate applications for the Agua Fria and Sun  
8     City West water districts no later than April 30, 2008, using 2007 as the test year, and no  
9     later than April 30, 2009, using 2008 as the test year for the Havasu water district.

10

11    **Q. Is Staff recommending a modification of Arizona-American's proposed permanent**  
12    **rate increase filing date for the Havasu water district?**

13    A. Yes, Staff recommends that Arizona-American file its Havasu rate application at the same  
14    date as the other two districts. Arizona-American did not provide any explanation for  
15    delaying the Havasu filing for an additional year, and it would be more efficient, if less  
16    convenient, to process the applications simultaneously.

17

18    **Q. What ACRM filing requirements is Staff recommending?**

19    A. Staff recommends that the Company's ACRM filings include hard copies of the ten  
20    schedules. In addition to the hard copy filings, Staff recommends that Microsoft Excel or  
21    compatible electronic versions of the filings and all work papers be concurrently provided  
22    to Staff. Further, Staff reserves the right for further discovery as it deems necessary  
23    related to the ACRM filings.



**ASENIC IMPACT FEE (HOOK-UP FEE)**

**Q. What is the Arsenic Impact Fee?**

A. According to the Company's application, the arsenic impact fee ("AIF") is a hook-up fee, which is applicable only for the Havasu water district, to be paid by new customers that would offset capital costs associated with arsenic treatment and disposal and lower the overall amount of the surcharge needed.

**Q. What concern does Staff have about the Company proposed Arsenic Impact Fee?**

A. Staff is concerned that hook-up fees may worsen the Company's capital structure and cash flow in the long run. The AIF is a zero cost source of capital. Although the AIF has zero cost, it has the affect of diluting the percentage of total capital represented by equity. In future rate cases, the AIF would represent contributions in aid of construction ("CIAC"). The Company would not earn a return on the CIAC or recover depreciation on the plant acquired by the AIF resulting in reduced cash flows.

**Q. Why is the Company's capital structure a concern?**

A. Financial risk increases as debt becomes a greater proportion and equity becomes a smaller proportion of total capital.

**Q. In general, what is an appropriate range for equity as a percent of total capital?**

A. An appropriate range for equity in the capital structure is between 40 and 60 percent.

**Q. What is the capital structure of typical water companies?**

A. Attached is Exhibit 1, which is Schedule AXR-2 of the surrebuttal testimony of Staff witness, Mr. Alejandro Ramirez, for the pending Chaparral City Water Company rate proceeding (Docket No. W-02113A-04-0616). Exhibit 1 shows that equity ranged from

1 44.6 percent to 56.9 percent of total capital for a sample of six water companies followed  
2 by Value Line. The capital structures of these water companies demonstrate the industry  
3 norm, and all of the sample companies have capital structures with equity representing  
4 between 40 percent and 60 percent of total capital.

5  
6 **Q. Do NARUC sponsored training classes recognize that a 40 percent proportion of**  
7 **equity in the capital structure is reasonable?**

8 A. Yes.

9  
10 **Q. What percentage of total capital was represented by equity in the capital structure**  
11 **adopted in Decision No. 67093?**

12 A. Equity represented 39.9 percent of total capital.

13  
14 **Q. What is Arizona-American's updated capital structure?**

15 A. As of December 31, 2004, Arizona-American reported \$23,803 in short-term debt,  
16 \$198,772,252 in long-term debt and \$115,410,355 in equity<sup>5</sup>, for total capital of  
17 \$314,206,410. This results in a capital structure consisting of 63.3 percent debt and 36.7  
18 percent equity.

19  
20 **Q. What is Arizona-American's capital structure when CIAC is considered?**

21 A. As of December 31, 2004, Arizona-American reported CIAC of \$20,762,038.<sup>6</sup> Including  
22 CIAC in the capital structure reduces the equity component to 34.45 percent  
23 [ $\$115,410,355 / (\$314,206,410 + \$20,762,038)$ ].  
24

---

<sup>5</sup> Source: Balance sheet (page 6) of the Company's 2004 Utilities Annual Report

<sup>6</sup> Source: Balance sheet (page 6) of the Company's 2004 Utilities Annual Report

1   **Q.   What has happened to the percentage of equity in Arizona-American's capital**  
2       **structure since its prior rate proceeding?**

3   **A.   Equity as a percentage of total capital has declined from a marginal 39.9 percent to 36.7**  
4       **percent as of December 31, 2004.**

5  
6   **Q.   In general, what affect would reducing the proportion of equity in the capital**  
7       **structure have on the weighted average cost of capital?**

8   **A.   Since equity is generally more expensive than debt, reducing equity decreases the**  
9       **weighted average cost of capital. Thus, if the weighted average cost of capital (i.e., the**  
10      **rate of return) authorized in the rate proceeding is used for the ACRM earnings test, the**  
11      **test will not recognize the Company's current lower capital cost. While Staff recognizes**  
12      **that lowering costs to increase efficiency and profitability is a legitimate objective for the**  
13      **Company, it should not be accomplished by inappropriate means such as an excessively**  
14      **leveraged capital structure.**

15  
16   **Q.   What are Staff's conclusions and recommendations regarding the Havasu AIF and**  
17      **the ACRM?**

18   **A.   Staff supports authorization of an AIF for Havasu as presented in Table 1<sup>7</sup>.**  
19

---

<sup>7</sup> As shown on the attached "Arsenic Impact Hook-Up Fee" tariff schedule.

Table 1

ARSENIC IMPACT FEE TABLE		
Meter Size	Meter Factor	Fee
5/8" x 3/4"	1	\$870
3/4"	1.5	\$1,305
1"	2.5	\$2,175
1-1/2"	5	\$4,350
2"	8	\$6,960
3"	16	\$13,920
4"	25	\$21,750
6"	50	\$43,500
8" or larger	80	\$69,600

Staff further concludes that in order for the Company to qualify for a special accommodation such as an ACRM, it should be required to obtain an appropriate capital structure. Accordingly, Staff recommends that Arizona-American file a plan with the Commission's Docket Control by December 31, 2005, that describes how the Company will attain and maintain a capital structure (equity, long-term debt, and short-term debt) with equity representing between 40 percent and 60 percent of total capital. Staff will address the plan in the Company's Paradise Valley Water Company rate proceeding (Docket No. W-01303A-05-0405).

Further, the Company should file an application for a permanent rate increase for its Agua Fria, Sun City West and Havasu water districts no later than April 30, 2008, using 2007 as the test year.

#### **HAVASU SCHEDULE 7, RATE BASE**

**Q. What information does the Company propose to be presented on Schedule 7?**

**A. The Company proposes to present the rate base calculation for the ACRM.**

1

2 **Q. Does the rate base calculation presented on Schedule 7 have a line item deduction**  
3 **that segregates the Arsenic Impact Fees from other CIAC?**

4 A. No, it does not.

5

6 **Q. What does Staff recommend?**

7 A. Staff recommends that Schedule 7 be modified to show a separate line item deduction for  
8 Arsenic Impact Fees.

9

10 **EARNINGS TEST - CONFORMING ADJUSTMENTS**

11 **Q. What does Staff recommend concerning the Earnings Test schedules to be filed in**  
12 **support of the ACRM and Arsenic Impact Fee?**

13 A. Staff recommends that the Earnings Test schedules filed in support of the ACRM  
14 incorporate adjustments conforming with Decision No. 67093. For example, the  
15 acquisition adjustment should be removed from rate base and the amortization of the  
16 adjustment should be removed from the income statement. The earnings test places a cap  
17 on the ACRM surcharge based on the existing authorized rate of return.

18

19 **Q. Does this conclude your direct testimony?**

20 A. Yes, it does.